

SUMMARY ANALYSIS OF AMENDED BILL

Author: Wildman Analyst: Gloria McConnell Bill Number: AB 1287
Related Bills: See Legislative History Telephone: 845-4336 Amended Date: 01/16/98
Attorney: Doug Powers Sponsor:

SUBJECT: Small Employer Health Care Credit

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _____.

AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _____.

FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO _____.

REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED/AMENDED _____ STILL APPLIES.

☒ OTHER - See comments below.

SUMMARY OF BILL

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (BCTL), for a period of five years, beginning on or after January 1, 1999, eligible small employers, as defined, would be allowed a credit for providing health coverage, as defined, to their employees or dependents thereof. The credit would be an "applicable percentage" of the monthly costs paid or incurred during the year. The "applicable percentage" would be 10% for years beginning in 1999 and would increase 5% each year thereafter to a maximum percentage of 25% for years beginning 2002 and thereafter.

The allowed credit would be in lieu of any deduction otherwise allowable, but the employer could elect to annually choose either the applicable deduction or the credit.

The California Research Bureau would be required to annually report to the Legislature on or before March 1, 2001, and each year thereafter on the effectiveness of the credit in encouraging small businesses to offer health insurance to employees.

SUMMARY OF AMENDMENT

The January 8, 1998, amendment removed provisions that relate to tax relief for small businesses that are impacted by the increased minimum wage and generally would have reenacted the small-employer health coverage credit, which would have

DEPARTMENTS THAT MAY BE AFFECTED:

___ STATE MANDATE

___ GOVERNOR'S APPOINTMENT

Department Director Position:

___ S ___ O
___ SA ___ OUA
___ N ___ NP
___ NA ___ NAR
___X___ PENDING

Agency Secretary Position:

___ S ___ O
___ SA ___ OUA
___ N ___ NP
___ NA ___ NAR
DEFER TO _____

GOVERNOR'S OFFICE USE

Position Approved ___
Position Disapproved ___
Position Noted ___

Department/Legislative Director Date
Gerald H. Goldberg 2/10/98

Agency Secretary Date

By: Date:

been operative January 1, 1993, but was repealed by SB 711 (Stats. 93, Ch. 74), effective on June 30, 1993.

This amendment reduces the credit percentage for each of the first three years, allows for the employer to elect to take either the applicable credit or deduction, limits the credit to five years (sunsetting December 1, 2004) and requires the California Research Bureau to report on the effectiveness of the credit on or before March 1, 2001, and each year thereafter.

EFFECTIVE DATE

As a tax levy, this bill would take effect immediately upon enactment but would apply to taxable or income years beginning on or after January 1, 1999.

LEGISLATIVE HISTORY

SB 2260 (Stats. 88, Ch 1521); SB 1207 (Stats. 89, Ch. 797); SB 107 (Stats. 91, Ch. 103); SB 617 (Stats. 92, Ch. 699); SB 711 (Stats. 93, Ch. 74); SB 102 (Stats. 93, Ch. 75); SB 1162 (1997).

PROGRAM HISTORY/BACKGROUND

The small-employer health coverage credit was enacted in 1988. The credit was limited to small employers who in the two years immediately preceding the operative date had not subsidized or provided health insurance. In 1989, the credit was amended to apply also to those small employers previously providing coverage. However, the operative date of that credit was delayed each year, so that the credit never became operative and eventually was repealed in 1993.

As part of the federal "Health Insurance Portability Act of 1996," beginning on or after January 1, 1997, as a pilot program, a certain number of employees covered under a small-employer-sponsored high deductible health coverage plan may establish a medical savings account (MSA) and be allowed a tax deduction for cash contributions they make to their MSA. While the limit is 750,000 taxpayers nationwide, previously uninsured individuals are not taken into consideration in determining whether the maximum is reached. Until the maximum is reached, any contributions that an employer makes to an employee's MSA are business expense deductions, and the amount contributed is not includible in the employee's income. Withdrawals from MSAs for qualified medical expenses, including long-term care and insurance contracts, are not taxable.

SPECIFIC FINDINGS

Under current California and federal law, employers are allowed a business expense deduction for subsidizing health care plans for their employees, which includes contributions by small employers to MSAs of eligible employees under the federal pilot program. Under the federal MSA law, to which California conforms, a small employer, in general, employs on average 50 or fewer employees.

Under this bill, taxpayers that employ on the average of no more than 25 employees during the year (small employer) would be allowed a credit against their income/franchise taxes for the cost of providing health coverage to eligible employees and their dependents. The allowed credit would be the sum of the "applicable percentage" of the total amount paid or incurred for health coverage for the individual, plus the covered individual's dependent or dependents.

The "applicable percentage" is as follows:

For taxable or income years beginning in 1999, 10%.
For taxable or income years beginning in 2000, 15%.
For taxable or income years beginning in 2001, 20%.
For taxable or income years beginning in 2002 and 2003, 25%.

An additional \$5 tax credit would be allowed per month per covered employee for each of two supplemental benefits the eligible small employer provides.

To qualify for the credit the eligible small employer must pay or incur at least 75% of the monthly health coverage premium for eligible individuals, for which the individual does not pay more than 25%, or in the event a dependent is covered, at least 75% per month toward the eligible individuals' dependent(s), for which the individual does not pay more than 25%, and

Participation must be made available within 60 days of employment to all eligible individuals, which could include part-time or seasonal employees if the employer elects to cover such individuals.

Currently, under federal and state law, amounts paid by an employer for employee benefits, including employer-provided health coverage, are deductible as a trade or business expense in computing taxable income.

Occasionally, the law provides that a taxpayer may "elect" alternate beneficial treatment of certain items. In making the election, the specific law requires that the items to which the election applies be identified, the election be made on the taxpayer's return and that the election be irrevocable except with FTB's consent.

Under this bill, the credit would be in lieu of any trade or business expense deduction to which the employer otherwise may be entitled for the same amounts on which the credit is claimed, but the taxpayer may annually elect to take either the deduction or credit.

Currently, under federal and state law, employer-provided health coverage is not includible as gross income of the employee.

Under this bill, in the event the amounts were to be includible in arriving at the employee's adjusted gross income for federal purposes, the amounts would be excludible for state purposes.

The bill would define "eligible employer," "eligible individual," "health coverage," "basic health care services" and "supplemental benefits."

Under this bill, the California Research Bureau, which is in the State Library, would be required to report annually to the Legislature beginning on or before March 1, 2001, on the effectiveness of the credit in encouraging small businesses to offer health insurance to employees.

Implementation Consideration

This bill would not significantly impact the department's programs; however, it is noted that the credit does not limit the number of years for which the

credit may be carried over. Actual experience indicates most credit carry-overs are exhausted within eight years, but without a limitation in the number of years that the credit may be carried over, the credit would continue to be mentioned in the tax forms. Additionally, of concern is that subdivision (j) and (k) make reference to "disability insurance," which does not appear to be included in the definition of "health coverage."

Technical Considerations

The manner in which the credit statute is structured may cause confusion. Also, amendments may be desired to remove language made unnecessary by related law changes between the time of previous legislation and the present. Amendments may also be necessary to clarify the language, in general. Upon request, staff will work with the author's office to make the following technical changes as the bill moves through the legislative process:

- Subdivision (a) indicates that the credit amounts are determined under subdivisions (b) and (c), yet subdivision (i) provides for additional credit amounts.
- Subdivision (b) pertains to credit amounts for individual coverage, and subdivision (c) pertains to credit amounts for dependent coverage. However, because the language for each subdivision is so similar, at first reading it appears to be duplicative and, therefore, may be misleading. Additionally, the first sentence of subdivision (b) makes reference to "that" health coverage. The health coverage at issue is "health coverage for an eligible individual" and should be so stated.
- Subdivision (b) provides that to qualify for the credit a certain percentage of the premium must be paid by the employer. It also provides that participation must be made available within a certain time but it is unclear whether this is condition must be met in order to qualify for the credit.
- Subdivision (g) provides for the sharing of expenses and allocation of the credit. This provision is unnecessary because, subsequent to the previous enactment of this credit, the sharing/allocation provisions are now included in Section 17039(e)(1)-(3) as a default allocation rule applicable to all credits in absence of specific statutory language to the contrary.
- Subdivision (h)(2) of the PITL provision in this bill begins to define an "eligible employer" as an "individual, estate, trust or partnership," whereas under BCTL subdivision (h) begins to define an "eligible employer" as a "taxpayer." The PITL provision doesn't make a blanket reference to "taxpayer" because before January 1, 1997, "taxpayer" did not specifically include partnerships and they were to be included. However, as of January 1, 1997, the term "taxpayer" does include partnerships, so the term "taxpayer" can be used under the PITL provision. Additionally, using the term "taxpayer" under the PITL provision would allow fiduciaries with employees to qualify for the credit.

- Subdivision (h)(3)(A) and (B) of both the PITL and BCTL provisions define "eligible individual" to include certain employees. To be consistent with the definitions used under the Unemployment Insurance Code, paragraphs (A) and (B) should provide that the services are those performed for "wages."

Additionally, from discussion with the author's office and Assembly Revenue and Taxation Committee staff, the amendment that allows the taxpayer to "elect" either the deduction or credit (page 3, lines 14-16 and page 8, lines 13-15) was to prevent the taxpayer from taking both the credit and deduction. It was overlooked that the bill already precludes the taxpayer from taking both the credit and deduction; therefore, the election provision should be eliminated to avoid confusion.

FISCAL IMPACT

Departmental Costs

This bill should not significantly impact the department's costs.

Tax Revenue Estimate

The estimated revenue impact of this bill is shown in the following table:

Revenue Impact of AB 1287 as Amended January 16, 1998 Effective BoA 1/1/99 (\$ Millions)				
1998-9	1999-00	2000-01	2001-2	2002-3
(\$28)	(\$137)	(\$324)	(\$550)	(\$725)

This analysis does not take into account any change in employment, personal income, or gross state product that may result from this bill becoming law.

Revenue Estimate Discussion

The estimated revenue losses reflect in this analysis are less than the estimate for the bill as amended January 1, 1998, and last year's bill (SB 1162), reflecting the lower percentage credit rates. The basic data, methodology, and assumptions used in developing the estimate for this bill, the bill as amended January 8, 1998, and SB 1162, are the same and discussed below.

The revenue impact of this bill would be determined by the qualified costs and the tax liability of taxpayers reporting those costs. The qualified costs will be determined by the number of qualified workers provided insurance by their employers and the amount spent by their employers for that coverage.

The revenue impact depends crucially on the number of qualified workers who are currently insured by their employers and the amount of employer paid costs for providing insurance. The number of qualified workers currently insured was developed from an estimate provided by the UCLA Center for Health Policy Research; 61% of workers in firms of 25 or fewer employees were insured in 1994. It is assumed that the percent coverage has not

changed significantly since 1994. For the cost of insurance staff used \$2,817, which is a weighted average of industry price quotes including those provided through the Health Insurance Plan of California (HIPC) for 1997. The insurance premium was grown to yield a weighted average for 1999, resulting in an insurance premium of \$3,409.

The estimate also takes into account the increase in spending for insurance that would result from this bill. This estimate assumes that for every one percent decrease in the after tax cost of insurance, there will be a corresponding one percent increase in spending for insurance. Note that a credit of 25% results in after tax reduction in costs of about 10% after accounting for the lost deduction (the credit is in lieu of the deduction) and federal taxes on the reduced state tax. This market response was evenly allocated to increased coverage of currently uninsured workers and to upgrading of existing insurance policies. Note that increased spending for health insurance tends to redirect income from taxable transactions (wages and profits) to transactions (insurance company income) that are not subject to PITL or BCTL. This estimate also takes into account the reduction in the tax base that results from this substitution effect. Finally, this estimate assumes that the interaction between the proposed credit and the recently enacted MSA legislation is minor. The MSA legislation is targeted toward catastrophic health care coverage while this bill targets basic health care coverage. In addition, the MSA program is restricted to those employees who participate in the federal pilot program which, although restricted to 750,000 participants nationwide, is not restricted to employees within a particular firm size category.

BOARD POSITION

Pending.